

ADOPTED 2/22/96

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeals of)
)Nos. 92R-1003
Control Data Corp.) 92N-0008
Commercial Credit Corp.)

Representing the Parties:

For Appellant:	James P. Kleier, Attorney
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For Respondent:	Charlotte Meisel, Counsel
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Counsel for Board of Equalization:	Tommy Leung, Staff Counsel
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OPINION

These appeals are made pursuant to sections 19045 (formerly section 25666)¹ and 19324 (formerly section 26075, subdivision (a)) of the Revenue and Taxation Code from the actions of the Franchise Tax Board on the protests of Control Data Corp. and Commercial Credit Corp. against proposed assessments of additional franchise tax and the claims of Control Data Corp. for refund of franchise tax, in the amounts and for the income years ended as follows:

¹ Unless otherwise specified, all section references hereinafter in the text of this opinion are to sections of the Revenue and Taxation Code as in effect for the income year in issue.

<u>Appellant</u>	<u>Income Years Ended</u>	<u>Proposed Assessments</u>	<u>Claims For Refund</u>
Control Data Corp.	12/31/78		\$ 76,839
	12/31/79		262,251
	12/31/80	\$ 79,366	82,186
	12/31/81	268,439	58,661
	12/31/82		13,453
Commercial Credit Corp.	12/31/79	36,835	

The issue presented in this case is whether dividends received by appellant Commercial Credit Corporation from its insurance subsidiaries are deductible.

Appellant Control Data Corporation (CDC) is incorporated in Delaware, with headquarters in Minnesota. Appellant Commercial Credit Corporation (CCC) is incorporated in Delaware with headquarters in Maryland. CCC is a wholly-owned subsidiary of CDC. CDC is engaged in the business of manufacturing and selling computers, computer systems and peripheral equipment, and in providing computer-related services. CCC is engaged, through its subsidiaries, in the business of providing financial services and insurance to business and individual consumers. Some of the financial services provided include personal loans and retail installment financing, accounts receivable and inventory financing, factoring, leasing and lease financing, interim mortgage lending, vehicle equipment financing, and wholesale financing. The types of insurance coverage offered include property, casualty, liability, automobile, workers compensation, fire, homeowners, life, credit life, credit disability, and health. Many of these insurance products are sold to clients of CCC's other finance subsidiaries.

CDC and CCC filed separate returns for 1978 and 1979; combined reports were filed for the 1980, 1981, and 1982 income years. CCC's insurance subsidiaries were not included in any of these returns, and dividends therefrom were reported as nonbusiness income and allocated outside of California. The appellants' returns were audited by the Multistate Tax Commission, which

recharacterized these dividends as apportionable business income. Consequently, respondent issued notices of proposed assessment, which were subsequently affirmed. These appeals followed.

Appellants do not dispute that they and their subsidiaries were engaged in a single unitary business during the years in issue. Instead, they claim that since California law prohibits insurance companies from being unitary with other general or financial corporations,² and because California law specifically allocates insurance company dividends directly to the parent company's domicile, the dividends in question should properly be characterized as nonbusiness income. In the alternative, if the dividends are determined to be business income, appellants argue that an allowance for the apportionment factors of the insurance subsidiaries should be included in the California apportionment formula. Moreover, appellants contend that section 24410, which excludes from the income of a corporation commercially domiciled in California dividends received from an insurance company, must be interpreted as being also applicable to nondomiciliary corporations or else it would be unconstitutional under the equal protection and commerce clauses.

The Uniform Division of Income for Tax Purposes Act (UDITPA) (Rev. & Tax. Code, §§ 25120-25139) distinguishes between "business income," which must be apportioned by formula, and "nonbusiness income," which is specifically allocated by situs or commercial domicile. The UDITPA definition of business income involves two separate tests, the transactional test and the functional test. Under the transactional test, the relevant inquiry is whether the transactions or activities which give rise to the income occurred in the regular course of the taxpayer's trade or business. Under the functional test, income is business income if the acquisition, management, and disposition of the income-producing property constitute integral parts of the taxpayer's regular trade or business operations, regardless of whether the income was derived from an occasional or extraordinary transaction. (Appeal of DPF, Inc., Cal. St. Bd. of Equal., Oct. 28, 1980; Appeal of Fairchild Industries, Inc., Cal. St. Bd. of Equal., Aug. 1, 1980; cf. Allied-Signal, Inc. v. Director, Division of Taxation, 504 U.S. __ [119 L.Ed.2d 533, 552] (1992) (the investment must "serve an operational rather than an investment function").) If either of these two tests is met, the income will constitute business income,³ and respondent's determination of

² The California Constitution exempts insurance companies from the franchise tax and subjects them to a gross premiums tax, which is in lieu of all other taxes. (Cal. Const., art. XIII, § 28, subd. (f).) Consequently, the Franchise Tax Board excludes insurance companies from combined reports and formula apportionment procedures. (See generally FTB Legal Ruling 385, Cal. St. Tax. Rep. (CCH) New Matters ¶ 205-232.) Thus, any elimination of intercompany dividends which might otherwise be achieved under the combined reporting rules is not available in this instance. (See generally Rev. & Tax. Code, § 25106; see also John McClure Estate, Inc. v. Johnson, 53 Cal.App.2d 512 (1942), for the non-applicability of the general dividend deduction rules under Revenue and Taxation Code section 24402.)

³ Appeal of DPF, Inc., *supra*.

the character of the income under these tests is presumed correct, with the taxpayer bearing the burden of proving it to be erroneous. (Appeal of Johns-Manville Sales Corp., Cal. St. Bd. of Equal., Aug. 17, 1983.) In addition, respondent's regulations provide that "income of the taxpayer is business income unless clearly classifiable as nonbusiness income." (Cal. Code Regs., tit. 18, reg. 25120, subd. (a).)

The income-producing property in the instant appeal, the stock of the unitary insurance subsidiaries, is clearly integrally related to the unitary business operations of the corporate group. In analogous situations, we have held that income derived from such property is business income subject to formula apportionment. (See Appeal of Occidental Petroleum Corporation, Cal. St. Bd. of Equal., June 21, 1983; Appeal of Standard Oil Company of California, Cal. St. Bd. of Equal., Mar. 2, 1983.) We see no reason to deviate from these holdings in this appeal, and now address appellants' alternative arguments.

Deductions are a matter of legislative grace and the burden is upon the taxpayer to show entitlement thereto. (New Colonial Ice Co., Inc. v. Helvering, 292 U.S. 435 [78 L.Ed. 1348] (1934).) Moreover, it is well established that the findings of the respondent are prima facie correct and that it is incumbent upon the taxpayer to prove them to be erroneous. (Todd v. McColgan, 89 Cal.App.2d 509 [201 P.2d 414] (1949).)

We find no legal basis for appellants' contention that respondent should take into account their insurance subsidiaries' apportionment factors when computing the unitary group's taxable income. Likewise, there is no statutory authority for allowing nondomiciliary corporations to take a deduction for dividends received from insurance companies. While appellants' equal protection and commerce clause arguments with respect to the section 24410 dividend exclusion limitation seem appealing, a finding in favor of appellants on these grounds is tantamount to an invalidation of the statute on constitutional grounds. However, section 3.5 of Article III of the California Constitution precludes us from making such a determination.

Based on the foregoing, the respondent's actions must be sustained.

ORDER

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED, AND DECREED, pursuant to sections 19047 and 19333 of the Revenue and Taxation Code, that the actions of the Franchise Tax Board on the protests of Control Data Corp. and Commercial Credit Corp. against proposed assessments of additional franchise tax and on the claims of Control Data Corp. for refund of franchise tax, in the amounts and for the income years ended as follows:

<u>Appellant</u>	<u>Income Years Ended</u>	<u>Proposed Assessments</u>	<u>Claims For Refund</u>
Control Data Corp.	12/31/78		\$ 76,839
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Commercial Credit Corp.	12/31/79	36,835	

be and the same are hereby sustained.

Done at Sacramento, California, this 22nd day of February, 1996, by the State Board of Equalization, with Board Members Mr. Klehs, Mr. Andal, Mr. Dronenburg, Mr. Sherman and Mr. Halverson present.

Johan Klehs _____, Chairman

Dean F. Andal _____, Member

Ernest J. Dronenburg, Jr. _____, Member

Brad Sherman _____, Member

Rex Halverson* _____, Member

*For Kathleen Connell, per Government Code section 7.9.